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UNCLAS SECTION 01 OF 02 HARARE 001966

SIPDIS

STATE FOR AF/S
USDOC FOR ROBERT TELCHIN
TREASURY FOR OREN WYCHE-SHAW
PASS USTR FLORIZELLE LISER
STATE PASS USAID FOR MARJORIE COPSON

SENSITIVE

¶E. O. 12958: N/A
TAGS: EFIN ECON ETRD EINV PGOV ZI
SUBJECT: A Rose-Tinted 2005 Budget

Sensitive but unclassified. Not for Internet posting.

Ref: a) Harare 1818 b) Harare 1588

¶1. (U) Summary: Echoing the line laid out in Reserve Bank (RBZ) Governor Gideon's Oct 28 address (ref a), acting GOZ Finance Minister Herbert Murerwa forecast robust 3.5-5 percent GDP growth and 30-50 percent inflation for
¶2005. In his long annual budget presentation to Parliament on Nov 25, Murerwa dodged everything and anything controversial, including why Chris Kuruneri, jailed since March, remains finance minister. Murerwa did not utter the phrase "exchange rate," the economy's most debated matter, and suggested no timetable for dealing with other macroeconomic distortions, such as negative real interest rates and high statutory reserve requirements. In our view, the GOZ will not achieve these bullish goals. Nonetheless, if the GOZ carries out a significant devaluation of the zimdollar in 2005, we feel the economy could register modest growth from its current depressed levels. End summary.

The Budget in a Nutshell

¶2. (U) The Finance Minister expects 3.5-5 percent positive growth driven by production increases of 16 percent in agriculture and 7.5 percent in mining. He did not project tourist sector growth but said it will "benefit tremendously" from a burgeoning influx of Chinese tourists. Murerwa forecast manufacturing output will recede by only 5 percent, its lowest annual decline since 1998. In order to spur growth, Murerwa proposes supply-side tax cuts by raising the thresholds for all tax brackets. Finally, Murerwa reiterated the RBZ's expectation of 30-50 percent inflation, down from the current 206 percent.

¶3. (SBU) Is it all possible? Since the GOZ has still to reach many critical decision crossroads, it is hard to forecast the economy's 2005 performance. For example, no observer could have predicted in late-2003 that gold exports would rebound from 12 to 20 tons this year, since Gono did not establish a preferential exchange rate for bullion until March. A significant devaluation, whether across-the-board or sectoral, would trigger an increase in exports and, by extension, GDP. Likewise, President Mugabe's sudden departure, unforeseen at this time, could cause tourism and foreign investment to surge. At this juncture, there are many unknowns to be able to make confident predictions, although Murerwa is gamely trying to put the best face on the situation.

Our Current Best-Guess Scenario

¶4. (SBU) With that caveat, we offer these cautious projections:

- Devaluation. We believe the GOZ will implement a hefty devaluation in 2005, most likely only after March's parliamentary elections. Operating at a Z$5600:US$ rate (a 50 percent discount to the parallel market rate), exporters are in such dire straits that even the GOZ will see the need to grant some relief. Perhaps tellingly, Murerwa's budget calls for 215 percent more spending in 2005 than in 2004, but forecasts only 30-50 percent inflation - implying an enormous and unexplained spike in expenditure even after controlling for inflation. We can only attribute this nominal spending increase to the GOZ's unspoken anticipation of a large devaluation.

- Economic Growth. Helped along by this devaluation, we feel GDP could register positive growth for the first time in seven years. But we believe it will be on the order of .5-1.5 percent rather than the GOZ's forecasted 3.5-5 percent. Even though economic output is far below

its late-1990s peaks, it seems ready to inch up in certain sectors. In tourism, international visitors to Zimbabwe are increasing marginally (a topic we elaborate upon in septel). In farming, our own unscientific observation suggests small-scale farmers - including land reform beneficiaries - have now prepared more land for planting than during the 2003/2004 season. Tobacco output may have bottomed out at 65 million kgs, roughly 75 percent below the 2000 harvest, while cotton output continues to grow rapidly. In mining, exports of asbestos, chrome and platinum could take advantage of high world prices, provided the GOZ allows a reasonable depreciation of the zimdollar as it has for gold exports (ref b).

- Inflation. We do not believe 30-50 percent inflation is plausible, especially after a significant devaluation. The inflation rate has fallen swiftly in recent months because the GOZ's Central Statistical Office (CSO) calculates inflation on a year-to-year basis (rather than annualizing the current month's rate) and Sept-Nov 2003 experienced the economy's highest monthly rates (between 25-34 percent). Because the Sept-Nov 2004 rates (which are well below Sept-Nov 2003 levels) are currently being included in the annual inflation rate calculations, these appear to be dropping rapidly. The impact will be more modest when, for example, Feb-Apr 2005 replaces Feb-Apr 2004's lower monthly rates of 5-6 percent. We also believe the GOZ will fan inflation by printing (i.e., expanding money supply) its way through a projected budget deficit of 5 percent of GDP, as there are no foreign inflows and few buyers for GOZ-issued bonds and treasury bills. In the past, the GOZ compelled local pension funds to invest in these "sucker" investments that carry negative real interest rates, but the pension fund "well" has now been mostly exhausted. Finally, statutory requirements for financial institutions, which the GOZ has been treating as a revenue source, have now reached a sky-high 60 percent. It's difficult to imagine many more increases. For these reasons, we see few options for deficit financing other than aggressive and inflationary money supply growth.

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